

General Information Letter: Explanation of use of the annualization method.

November 8, 2005

Dear:

Your letter to Paul Caselton, dated October 21, 2005, in which you request advice, has been referred to the undersigned for a reply. Department of Revenue ("Department") regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of agency policy that apply, interpret or prescribe the tax laws and are not binding on the Department. For your general information, the regulation governing the issuance of letter rulings, 2 Ill. Adm. Code Part 1200 regarding rulings and other information issued by the Department, can be accessed at the Department's website. That address is [www.revenue.state.il.us/legalinformation/regs/part1200](http://www.revenue.state.il.us/legalinformation/regs/part1200).

The nature of your question and the information provided require that we respond only with a GIL.

In your letter you state as follows:

I was referred to you by the Taxpayer Assistance Division, for assistance in resolving a tax problem that is beyond their authority.

I am a semi-retired mechanical designer, on Social Security, but I still do a few projects (less than 10 projects per year) for old clients. Due to the steadily increasing cost of fuel, taxes, and insurance, I need the extra income to pay to the monthly bills.

In each project, I am hired as an 'outside vendor,' and paid a lump sum when the project is finished. Due to the companies' budget timing and allocation policies, 'fast track' installation, and/or emergency equipment replacement due to the failure of the existing equipment, I never know how much work I will do in any given tax year.

Additionally, much of the work is done in the Summer and Fall, with payment arriving in the fourth quarter of the year. Sometimes, the first two quarters of the year yield little or no additional income from this work, as there are few, if any, projects finished during that period.

When I first began this work 2 1/2 years ago, I called IRS and IDR and explained the situation. Due to the fact that I do not have sufficient funds on un-received income, and the fact that the dollar amount of income is not predictable, I asked if I could just send in 35% of the gross to the IRS and 3% of the gross to IDR each time I received a check. In essence, I would be paying my tax obligation similar to a commercial fisherman or a farmer.

Both IRS and IDR stated that this would be an acceptable alternative to quarterly payments, provided that the balance in the account was equal to or exceeded the taxes owed for that calendar year. They stated that their computers would have codes entered

into them that this was a special situation, but significant fines would be imposed if the monies paid in did not equal or exceed the tax obligations for the calendar year. Overpayments could be easily resolved by prepaying on the following year taxes and/or refunding.

Tax year 2003, the above arrangement was accepted by both IRS and IDR.

Tax year 2004, the above arrangement was accepted by IRS, but I was fined \$35.00 by IDR, because my payments were not equal quarter monthly, even though there was a balance in the account exceeding the tax obligation by more than \$600.00.

After 5 months of letters and phone calls, the fine was rescinded and refunded to me, and I was told the person I had talked to about the alternative payment method 'was no longer employed by the IDR,' and that there was no provision in the law for other than '4 EQUAL, quarterly payments per year,' even though most of my income arrives in the fourth quarter of the year, is not predictable, and that I do not have the money to pay taxes on un-received income.

As soon as I receive confirmation of the deposit, I send off the checks to IRS and IDR. I am not trying to evade taxes.

Arrangements are nearly automatic for farmers and commercial fishermen.

I want to pay my fair share – and I pay it as soon as I receive the money. All I want to do is not be penalized for not being an employee subject to the withholding of tax money.

Can we reach an agreement that is FAIR to both IDR and me?

Section 803(a) of the Illinois Income Tax Act requires that every taxpayer other than an estate, trust, partnership, Subchapter S corporation or farmer is required to pay estimated tax for the taxable year if the amount payable as estimated tax can reasonably be expected to be more than \$250, or \$400 for corporations. IITA Section 804 explains the calculation of the penalty for failure to pay estimated income tax. The penalty for underpayment is 15% of the amount of the underpayment.

IITA Section 804(b) explains the manner in which the amount of underpayment is calculated. The amount of underpayment is determined by comparing the amount of the required quarterly installment (25% of the amount of the required annual payment) to the amount of the installment actually paid by the taxpayer. The amount of the required annual payment of estimated tax is the lesser of 90% of the tax shown on the return for the taxable year, or if no return is filed, 90% of the tax for such year, or 100% of the tax shown on the return of the taxpayer for the preceding taxable year if a return showing a liability for tax was filed by the taxpayer for the preceding taxable year. In the case of individuals and corporations, if in the prior year a taxpayer was not required to file a return, even though IITA Section 803 might impose a requirement of making estimated tax payments, no penalty will be imposed under Section 804 if the taxpayer makes no estimated payments, or underpays his estimated payments. In addition, in the case of individuals, if the taxpayer filed a return but had zero tax liability, no penalty will be imposed if the taxpayer makes no estimated tax payments or underpays his estimated payments. Use Form IL-1040-ES, Estimated Income Tax Payments for Individuals, to compute and pay your obligations.

You state that receiving most of your non-wage income in the 3<sup>rd</sup> or 4<sup>th</sup> quarters renders you unable to pay tax on money not yet received during a given taxable year and that your estimated tax is hard to gauge because your income is unpredictable. In cases such as yours, Illinois allows you to compute your estimated tax obligation for each quarter by "annualizing" the income you have received so far. See Illinois Income Tax Act Section 804(c)(2) (35 ILCS 5/804). The computation of estimated tax due using this annualization method is contained in Step 6 of Form 2210, Computation of Penalties for Individuals.

As stated above, this is a GIL which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you wish to obtain a PLR which will bind the Department with respect to the application of the law to specific facts, please submit a request conforming to the requirements of 2 Ill. Adm. Code Part 1200.

Sincerely yours,

Jackson E. Donley,  
Senior Counsel-Income Tax